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Memorandum

To: Alan Rosenzweig
From: Virginia Rutledge
Re: Danfoss Turbocor review

In November 2005, the County requested that PFM review available information on the financial issues related to a possible economic development venture related to manufacturing company that was considering relocation to Tallahassee. At the time, we had limited information on which to base that review, and provided the County with comments on that information. The County has asked us to further review the proposed relocation, and related issues based on more recently available information. This memo serves to update you on what we have found.

Brief history of DTC. The original Turbocor started out as a research and development company in Australia in 1993. It moved to Montreal in 1999. Their compressors were first marketed commercially in 2002. In 2004, Turbocor and Denmark-based Danfoss formed a 50/50 joint venture named Danfoss Turbocor Compressors Inc. 2005 is the first full year of the joint venture.

Products. DTC develops and manufactures high efficiency compressors for HVAC applications. According to information provided by DTC, their equipment is 30-40% more efficient (i.e., uses less electricity to run) than conventional technology. They currently manufacture several sizes of compressors and are in the process of developing larger sizes as well.

Organization. DTC is currently a joint venture with two owners. Each of the owners has two representatives on the four-member board of directors. The parties are:

- Danfoss A/S (www.danfoss.com), an international company headquartered in Denmark. Danfoss is a privately held company. Its key business lines include air conditioning and refrigeration, heating, and motion controls. Currently, most of their sales are in Europe, though they also operate in North America and Asia. The Turbocor relationship is mentioned in their 2004 annual report. Danfoss reports over 18,000 employees globally. Financial statements are reported in DKK (Danish Krone); their current auditor is KPMG C. Jespersen. Total 2004 sales were reported at 16.345 billion DKK, or about $2.73 billion USD.

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- The other party in the joint venture is Turbocorp BV. Over 92% of Turbocorp BV is owned by Shandong, a private limited liability company that serves as a vehicle for a small group of private investors who invest in different types of business ventures on a global basis.

Security. Under the proposed arrangement, DTC's arrangement with the County, City, and/or other governmental participants would be secured by a lease for the building. The lease would require DTC to make ongoing lease payments for the facility that would be constructed for their use. The facility would be owned by some governmental entities (the exact structure is not final), not DTC. Additionally, discussions have indicated that DTC will also pledge certain equipment to secure the governments' cash investment.

The joint venture participants are not separately securing the lease separate from their commitments/ investment in DTC. However, the lease payments should come ahead of DTC's debenture (provided by Danfoss), as well as investors' equity. This does *not* mean that no DTC debt will be repaid for the life of the lease. As a part of the final lease and contract development, the County should make sure that no other forms of indebtedness or commitments will be secured ahead of the lease. Additionally, the contracts should clarify the pledge of the equipment as well.

Sources of information. As a part of its review, PFM has accessed a number of sources of information, including:

- Reviewed publicly available information on both DTC and Danfoss.

- Had discussions with the president of DTC (who came to DTC via the Atlanta-based operation of Danfoss).

- Had discussions with a Director for Turbocor B.V., who has been involved in overseeing their investment in DTC.

- Reviewed the historical financial information for DTC provided by the company.

- Reviewed future projections of sales, financial performance and other information provided by the company.

- Reviewed certain limited information provided by the company under a confidentiality agreement as to key customers and contracts. While we have had discussions about DTC's business strategy, customer base, and other important issues, we will not be including any details of them in this report. We would comment with all of the discussions and information that we have reviewed, that we cannot independently verify or guarantee that information.

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Financial status of the company. While DTC has products in commercial operation, it is still in the early stages of development for an operating company.

- FY 2005, the first full year of operations of the new entity, is projected to show a net loss of over $8 million. This, as well as other cash flow needs, is being provided in the form of a loan from Danfoss. FY 2006 is also expected to show a loss both in income and cash flow, although smaller than 2005. There is a commitment for an additional loan for 2006. DTC projects positive cash flow for 2007.

- The financial projections show substantial increases in production levels each year, with projected sales revenues projected to nearly double in each year through 2008.

- While the changes in the numbers seem extremely large, they are not entirely surprising for a newer product. Working from a smaller base, percentage changes may be large. Additionally, while the historical financial information is interesting, it does not really provide a basis for whether the future results are realistic or achievable. Please see the discussion below.

What can help to make this successful. There are a number of factors in place that should help make DTC a success.

- In the early stages of a company's growth, when they are not profitable, the access to funds, or the lack thereof, can be a fatal problem. DTC's investors have provided the funds to deal with losses, and have indicated that they are longer term investors, i.e., not just looking for a quick return. The DTC joint venture partners have put their own funds at risk, and should have every reason to want this to be successful.

- There appear to be synergies between DTC and Danfoss, one of the two investors in DTC. This can be helpful in terms of company success; they should understand the business; have provided the current company president; and allow DTC access to economies of larger purchases of materials and to their suppliers. DTC should also be able to take advantage of marketing efforts and customer relationships in some markets.

- Given that such a product may need long term support, the Danfoss name/ investment is likely a factor in the comfort of potential customers who may be concerned about whether the new entity will be around for the duration.

- The investors appear to have the resources to work at making this a successful company, and the willingness to be involved if necessary.

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- They already have customers signed to multi-year agreements.

- It appears that customers who purchase the products must make an investment in integrating it into their end products (i.e., commercial size air conditioners). This suggests that when they do buy into the product, they are likely considering it a multi year/ longer term commitment.

- They appear to have a unique product that, if it delivers as expected, offers significant energy efficiencies at a time when there have been rising energy costs.

What can go wrong. Even large and/ or mature companies can make missteps and implode. There are not usually guarantees to success, and there will clearly be uncertainties with a new company that is still in the initial growth stages. While there is typically a long list of challenges for any company, some key issues appear to be:

- Whether their product, which is relatively new, will perform as expected. Reliability will likely be important to the ability to grow the business. If the product doesn't meet expectations, customers may be unwilling to take a chance on a "different" technology; they will only get the expected benefits if the product proves reliable in the long-run.

- This appears to be a product (at least for new units) for which there is a long lead time in gaining customers.

- If growth and profitability do not develop as expected, the question will be just how long the investors will be patient, and what they will do to address the problem. There is a point at which they may simply decide to cut their losses. While the investors appear to have the means to support the company, they must also have the willingness.

- While there are customer agreements with DTC to supply them with the compressors; contract terms are more likely to have targets and pricing structures that provide lower unit prices for higher volumes. They will not always have absolute commitments for minimum purchase levels.

- Other companies may develop a new product that out-performs the DTC line.

Overall comments. Governments are usually conservative by nature and often look for guarantees of success before investing public resources. There are not going to be any real certainties in such an arrangement. The company, in its development cycle, is closer to the venture capital mode than mature industry. That said, they also have real support, capital, contracts, and other features that bolster their likelihood of success. Additionally, their investors should have every reason to want to make this successful as well; it appears that they would lose a substantial investment of their own if

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it were to fail. Governments have very different philosophies when it comes to investment in economic development. In this case, the governments ultimately need to decide whether:

- The industry is the type that they would like to bring into the region and the jobs creation expectation is sufficient to warrant the investment;

- The combination of the company's business strategy; patient investors with capital to inject and/or investors that have real capital at risk is a sufficient package to give the governments a sufficient level of comfort;

- The security structure is satisfactory to the governments, and/ or whether they can finalize the structure of the security to the satisfaction of all the parties;

- This investment is the optimum use of such resources, from an economic development perspective, as compared to other opportunities.

I hope this information is helpful to you in analyzing the issues. Please let me know if you have any questions.